DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 15196
San Diego, California

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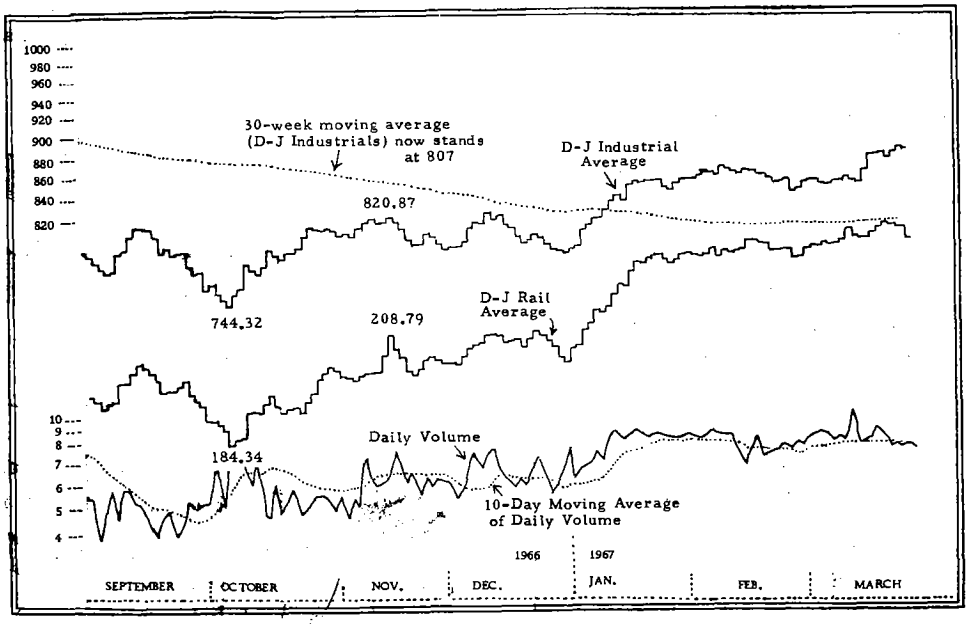
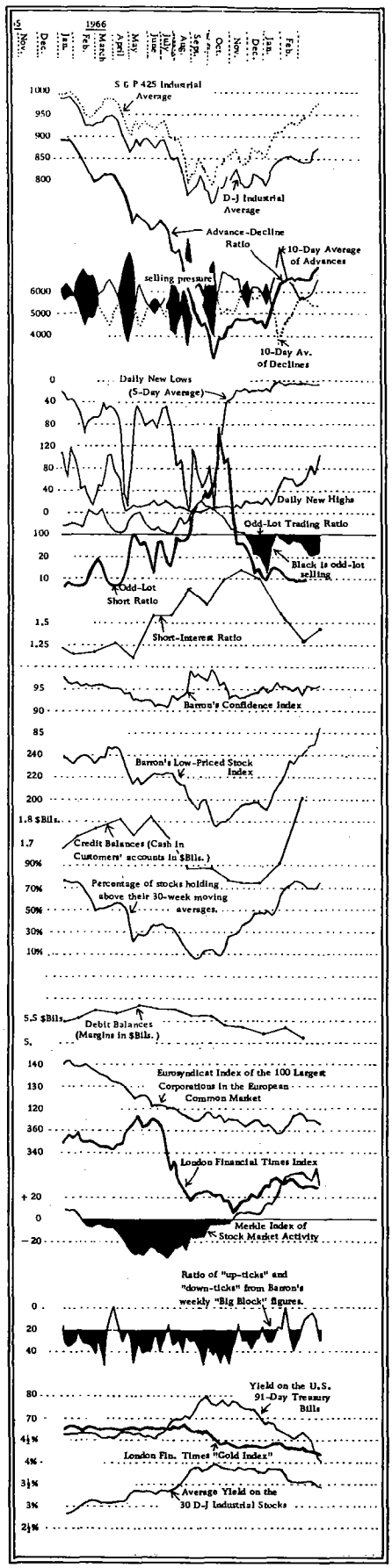
THE MARKET: Hysteria is in the air, one can feel it, one can see it as one studies the frenzied activity in the security markets. Volume in 1967 has risen to proportions never before seen on the New York Stock Exchange, and in fact, a day which brings forth volume under 10 million shares is now considered "sluggish." A "hot tip," a merger rumor, a news item, can send a stock up or down 10% to 15% in a few hours. Analysts who were bearish only a month or so ago are now bullish and are advising speculative purchases in this high-flying market. Due to the impetus of computers and "performance funds," movements which would have been completed in a matter of months a few years ago are now completed in a few days or weeks. The stock market has jumped onto a "speculative speedway" and those entering it must feel much as a repair man who is asked to work on an engine which is turning over at top speed. One slip of the screwdriver and pieces of the engine fly in all directions.

Perhaps the newest aspect of the picture is the emergence of the freeswinging, heavy-trading institutional fund. So far in 1967 there has been an average of 25 "Big Board" transactions a day involving blocks of 10 thousand or more shares. This compares with an average of 14 such blocks per day during 1966. It is estimated that institutional action amounts to 32% of all Big Board activity at this point. Under increasing pressure to "perform," the institutions are now acting like the traders of five or ten years ago.

True, the stock market is not operating in a vacuum. In large part, it is reacting to what my friend Eliot Janeway has just dubbed "operation tanglefoot." "Washington is stampeding in all directions at once," writes Janeway in his latest report. "Not that consistency is any more indispensable to politicians than to the ladies; simply that frantic new moves in response to pressures arising from frantic old moves are creating new problems faster than they are solving old ones."

Let's look at the economic picture. Only a few months ago Washington was fretting about the "overheated economy" and the steady, inflationary climb of prices. Then the signs of softening came, and in a short space of time, among other things (1) LBJ asked Congress to reinstate the 7% investment tax credit, (2) the Federal Home Loan Bank reduced interest rates to savings & loan companies, (3) $380 million of mortgage credit, previously frozen, has been released, (4) reserve of commercial banks have been reduced below 4%, (5) the Fed, last week, added $1.3 billion of Government securities to its holdings, the biggest buying spree since 1962, thus pushing bank reserves to the




S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline Ratio
10-Day Average of Advances
selling pressure
10-Day Av. of Declines
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-Lot Short Ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Credit Balances (Cash in Customers' accounts in $Bils.)
Percentage of stocks holding above their 30-week moving averages.
Debit Balances (Margins in $Bils.)
Eurosyndicat Index of the 100 Largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
Ratio of "up-ticks" and "down-ticks" from Barron's weekly "Big Block" figures.
Yield on the U.S. 91-Day Treasury Bills
London Fin. Times "Gold Index"
Average Yield on the 30 D-J Industrial Stocks

 plus side, (6) $175 million of a recent $1.1 billion cutback was added to the Federal highway construction program.

It has been said that President Johnson has an almost psychopathic fear of recession. But even here, one cannot tell for sure whether the President's current fears are justified as yet. Some economists have announced that the private sector of the economy is now in recession, while others doubt that a "true recession" is going to materialize at all this year. At any rate, it is clear that LBJ has put all available pressure on the various Government agencies to "open the valves." He is not waiting for any official announcement of possible recession from the Council of Economic Advisors or the National Bureau of Economic Research. He has pressed the "panic button," and he has pressed it hard.

We must remember that Wall Street and the public has been conditioned since 1932 to successful Government pump-priming policies. Since 1949 inflationary policies have become even bolder, and the Johnson Administration today is resorting to tactics which would have been considered unbelievable during the Roosevelt-days of the 1930's. In the minds of the New Economists and the Federal Agency officials, the U.S. public may be likened to Pavlov's dog, spending more whenever money becomes more available, going further in debt if and when the Government decides that more "stimulants" are necessary.

NOTES & QUOTES: When a man is engaged in a poker game, and he sinks deeper and deeper into the red, he is liable to forget about his earlier intentions of a "little profit." In his desperation, he may well go for "double or nothing," or some other drastic plan calculated to take him out of his frightening situation. It seems to me that President Johnson now finds himself in the same position in Vietnam. We have increased our commitment from 25 thousand men in Vietnam two years ago to 427 thousand men today. Expenses of the war can only be described as astronomical, running near $3 billions per month. "In Vietnam," wrote James Reston of the New York Times (last week), "the U.S. is dropping more bombs than it did at the most severe and savage part of the European war." The cost of the Vietnam war since mid-1964 has been $48 billions. That is $4 billions more than total U.S. aid to all nations of the world since World War II. Many consider this war to be the single greatest waste of capital in human history.

It now appears that President Johnson is going for a military victory, rather than risk a belated negotiated peace. Bombing is to be stepped up even further in an effort to bring Hanoi to the "peace" table. Peace overtures are still mouthed by the Administration, but most of us hardly listen any more. There have been too many secrets, too much "managed news," too much tommy-rot, the average American has given up trying to sift the truth from either side.

One thing should be watched from here. Russia, as leader of the Communist world (and this goes for China as well) is being put on a very tight spot by the bombing, and she will be in an even more embarrassing situation if bombing is increased. For here is the U.S. bombing a Communist nation almost at will while Russia, the giant of the Communist world, is unable to stop the carnage. The situation, in my opinion, is becoming increasingly dangerous as it is causing Russia and China to lose face before their satelites. No one knows what the next step will be in this war of blood, frustration and nerves.

* * * *

From the latest Alden Wells Monetary Report (Box 401, Exeter, New Hampshire 03833): "A year ago the historic highs in bank loan ratios and the velocity of money, high trading volume and prices of stocks, and an all-time low in corporate liquidity indicated that inflation had consumed all the liquid capital possible. It would therefore be restored by deflation. The first year that happens the government does not believe it, and flounders through some rapidly changing expedients. The financial community does not believe it, and reports each decline in the stock market is the last and each rally the beginning of a new boom. The businessman does not believe it, and maintains production while inventories rise.

"The second year, if the government is so rigid as to be unable to adjust, businessmen reduce production below sales to work off inventories. Individuals turn to saving rather than borrowing. The government's deficit skyrockets but not enough to offset private deflation. As savings increase and debt is reduced, interest rates decline. Then foreign money becomes repatriated, and an international monetary crisis developes."

From the March 16 report by Argus Research: "At this point we might express our complete disagreement with the survey's forecast of rising capital expenditures in the second half of the year. In spite of the reinstatement of tax credit and accelerated depreciation effective last Thursday, the fundamental determinants of capital spending strongly suggest that a downward trend will persist through the balance of the year and probably longer. In our judgment, the amplitude of that trend will only be less precipitously downward than indicated before last week's action on the tax credit and accelerated depreciation."

Signs of the Times: A rock 'n roll band in San Francisco calls itself, "Dow Jones and the Averages."..... Volkswagen president Nordoff has christened its new $1,121 economy model car, "the Economic Crisis Beetle."... In its first documentary film for Soviet TV, the Russians presented a surprising subject— Wall Street and the U.S. stock market.

A current anecdote has it that two investors meet. "The market is up today," states one investor. "Oh really," answers the other, "what did Johnson say today?" There is a bit of irony in that little story, but what bothers me most is the long-term implication of what our Government is doing. Attempts to manipulate the primary trend have always failed in the past; I believe that they are going to fail again today. But manipulatory practices can extend the primary trend. Just as the major corrections of 1953-54, 1957-58, 1960 and 1962 extended the life of the great bull market, so, I believe, the current upward retracement will extend the ultimate life of this primary bear market.

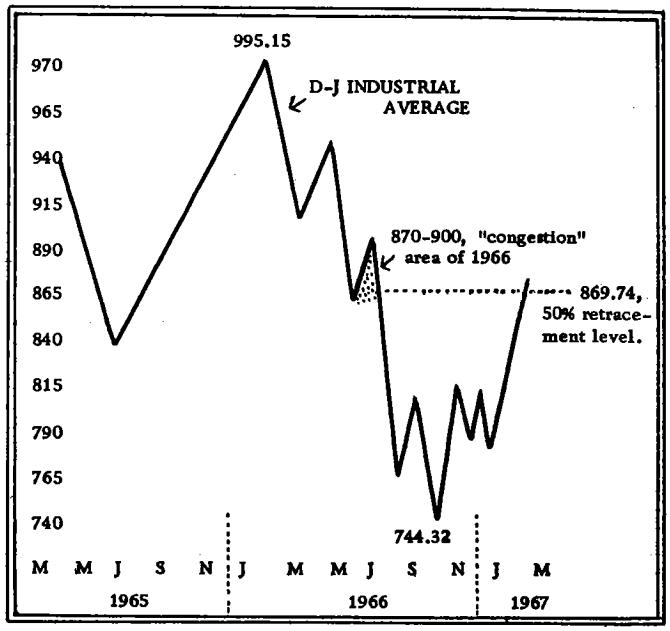
From the standpoint of the nation and my subscribers, I was hoping that this bear market would be relatively short even though it might be deep. But I feel that the Government's current inflationary attempts to hold back or reverse the primary bear markets are fated, not to reverse the primary trend, but to extend it. Because of all the new "water" being pumped into the economy it is probable that the ultimate purging will take the market deeper and further than was previously "in the cards."

On Thursday, March 23, the Industrial Average closed at 876.67, 7 points above the 50% level of the entire 1966 decline. Since I first wrote about Dow's 50% Principle some years ago, a great many analysts and services have picked up and written about this principle. When too many people watch the same thing in the stock market, that principle frequently does not work the way it might ordinarily be expected to work. Thus, although the Industrial Average halted its climb at almost exactly the 50% level of the 1966 decline (see chart), it is still possible that it may go higher.

Applied to a bear market, the 50% Principle states that if an upward correction halts before or at the halfway level of a previous major decline, the probabilities are that the Averages will turn down again, and approach or break the previous lows. Conversely, if a retracement carries beyond the halfway level of a previous major decline, the probabilities are that the previous highs will be approached again.

In the present instance, the Industrial Average closed on March 23 at 876.67, approximately 1% above the theoretical halfway level of the 1966 decline. Rails recorded their recovery high on March 17 at 235.17 and have not (as of this writing) confirmed the new Industrial

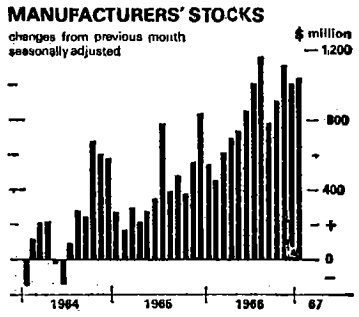
high. Nevertheless, if Industrials can hold persistently above the halfway level (869.74), it will be a bullish omen for the market under the 50% Principle. In that case, the odds will be raised considerably regarding at least an approach to or a "double top" in the February, 1966, all time high area.



On the other hand, I consider anything around 870-880 to be roughly within the area of the halfway level. Therefore, if the Dow is unable to make appreciable progress from the 870-880 zone, and it then drops below the 869.74 halfway level, I would conclude that the market has not been able to bring about a bullish resolution of the 50% Principle. In that case, lower prices and an ultimate smashing of the 1966 lows would be in order.

As to policy, I consider that we are still in the second phase of the bear market, the most deceptive and treacherous period of any bear market. I continue to advise subscribers to stay out of this market, to leave the "easy pickings" and "smart plays" to the speculators who are willing to attempt to outguess Wall Street during its most violent period of the bear market. I would prefer to let this advance "blow itself out" while we stay on the sidelines as interested observers. The great bargains, the great values in dividends-paying blue chips and growth stocks will come later in the cycle. Then it will be a question of who is solvent enough to take advantage of once-in-a-lifetime bargains.

ECONOMICS: At the crest of a business cycle (see accompanying chart), it is normal to find consumers loaded with merchandise of every variety. It is also normal to find businesses sitting with large inventories and for business inventorying to be proceeding at a rapid "build-up" rate. This is what has been happening over the past year.



Now the signs of inventory "indigestion" are being seen on every hand. Buying in all sectors of the consumer economy is slowing down, and (as usual) it has caught the business world in a position of high production rates and mounting inventories. Classically, the next step should be an effort by business to adjust inventories to the new lower rate of sales, and this would mean a cut-back in production below the current sales rate (so that inventories can be reduced). Adding to the problem, in recent years industry capacity has risen faster than consumption, so that a leveling off or a reversal in the rate of sales is bound to cause much cutting back and many shut-downs in production facilities.

When plants cut back and shut down, consumer sentiment often turns pessimistic, and in an article in last week's Wall Street Journal (see clip) the case was documented. According to the Journal's reporters, consumers are worried about the mounting cut-backs and they are turning conservative. They are saving more and buying less.

All very normal from the standpoint of classical economics. But the New Economics can tolerate no such thing. Inflation and economic frenzy is tolerable by New Economics standards, but a slowdown is absolutely unacceptable. For one thing, a slowdown is bad for votes, and the New Economics is highly sensitive to the voter. Secondly, with a war on and with huge Government spending programs in progress, any slowdown will mean reduced Federal tax receipts. Lower receipts will mean towering deficits, and although big deficits are accepted by the New Economists each year, no one can be sure how the American public would react to a mountainous deficit of say $20 or $30 billion dollars.

Although most people associate big deficits with more inflation and great prosperity, history shows that large deficits upset the public and are frequently accompanied by loss of confidence and reduced spending by the private sector (so that the net effect is deflationary).

With it all, the great argument is whether current pump-priming operations by Washington and tax incentives to business will actually result in increased spending in the corporate

Cautious Consumers

Fears Over Economy Cause Public to Save More, Shop Carefully

Shift in Mood Is Underscored By Close Look at Syracuse; Autos, Appliances Suffer

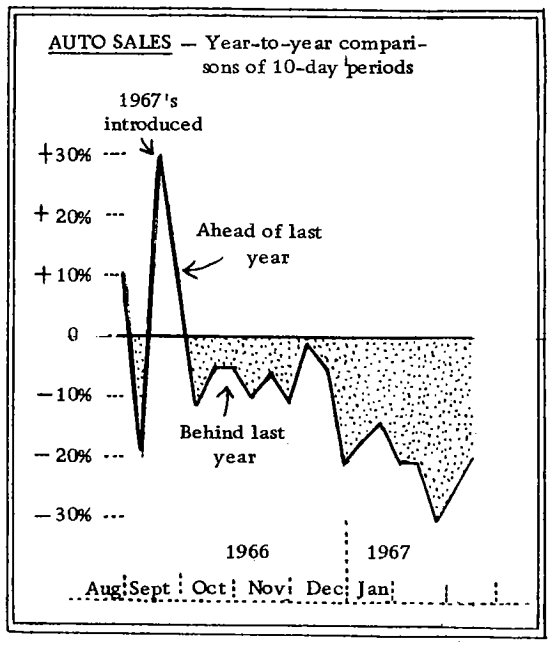
Repercussions From Layoffs

By FREDERICK C. KLEIN
Staff Reporter of THE WALL STREET JOURNAL

SYRACUSE, N.Y.—Dick Foote, a 33-year-old telephone serviceman, is saving more money these days. Besides the $25 a week he has been putting into his company's credit union for some time, he lately has been socking away $5 to $10 a week in a bank savings account. He hasn't made any major purchases for several months and isn't planning any now.

and consumer sectors of the economy. It is a question of whether consumers, who are now "up to their ears" in goods of all types, and corporations, who are now suffering from large inventories and over-capacity, will nevertheless respond to Government monetary and tax incentives and "go over their heads" again. Personally, I do not believe at this juncture, that the Government is going to be able to turn back the natural forces which call for a period of correction. Time will tell.

CHART OF THE WEEK: In Letter 348 I included this chart, and I thought it would be interesting to up-date it along with the lead-off comment from the Monday (March 27) Wall Street Journal. Note the stubbornness of the nation's analysts in recognizing what is occurring. Earlier auto sales estimates for 1967 were 8.5 million; they then dropped to 8.3 million in February, while many analysts now admit the possibility of an under 8.3 million year. The actual fact is that car sales are going at around a 7 million annualized basis. My friends at Indicator Digest are even less hopeful about car sales than I am. Their latest estimate is expressed this way, "Would you believe 6.5 million?"



LATE NOTES: Professional opinion is becoming fantastically bullish about the market, and all thoughts of this still being a primary bear market are either being pushed into the background or completely dismissed. It appears that we are entering one of those rare periods wherein all the Wall Street "pros" start thinking the same way. All of them are talking about the odd-lot selling, and they forget that recent turns have come more and more under conditions where odd-lots have told us little until the turn. At the turn down odd-lotters start selling less or buying more, and thus the signal comes simultaneously with the market downturn, rather than preceding it.

The second great bull argument is that the short interest is near historically high levels, but here too we might note that it is normal for a bear market to contain a consistently large short interest. Furthermore, it is notable that the short interest should always be viewed within the context of average daily volume. This "ratio" is now 1.4, under the normally bullish 1.5 ratio, and therefore I am not impressed with the overwhelming bullishness of the short interest ratio.

Investors Intelligence keeps a bi-weekly tabulation of the bullish or bearish stances of 66 separate investment services. Their latest count shows that "...The outright bulls gained a whopping 22.7% to end up at 56%." This is by far the largest percentage of bullish services since the October low. Adding to this the 16.7% of the services who believe we are in a consolidation of a bull market, Investors Intelligence concludes that "total bulls remain at 72.7%." In other words, three out of four services are now bullish, and bullish professional sentiment rarely climbs higher than this. This type of analysis is hardly an exact timing device for a turn, but it does suggest that we are entering the area where a "surprise" could occur at any time. The surprise, in my opinion, would be a re-assertion of the primary bear forces in the market.

AUTO MAKERS are revising production schedules downward as prospects weaken for a sales rebound this spring. First quarter sales will fall 21% from 1966 and marketing specialists are forecasting second quarter sales 2.5% to 9% lower than a year earlier. Industry sources say production schedules for the second quarter have been trimmed to 2,075,000 cars, down 14% from last year and 125,000 cars less than projected only a few weeks ago.

Somewhere along the line, this bear market is going to produce a panic. I have been thinking a good deal about what could cause such an event. My own conclusion is that a panic will be set off when it is seen that all the Government stimulants (counter to anything this generation has experienced) have failed to turn the primary trend of the economy up. It takes surprise and disillusionment to produce a stock market panic. Investors have to be caught unaware. Obviously, this market is still banking on an upturn during the latter part of 1967 or early 1968. Whether such an upturn materializes within this primary bear market remains to be seen.

LATE COMMENTS: In interviews last week with people all over the nation, the National Observer found that the biggest question on everybody's mind was Vietnam. In their anger or exasperation, the majority believed we should "go in to win—or get out." My own feeling is that this nation has failed to comprehend the tremendous implications of our policies in Asia. In an interview with the New York Times, Edgar Snow (a long-term China expert and author of the famous book, "Red Star Over China") stated, "China will seek no war with the U.S.," but he predicted that they would continue their "short-of-war support for so-called people's liberation struggles."

Said Snow, "We are probably at the beginning, not the end, of a prolonged struggle between American and Chinese nationalisms over the political destiny of eastern Asia. One Vietnam has been able to frustrate the American political will for more than a decade. Probably Mao believes that a second and a third Vietnam must occur before the U.S. changes its policies." Snow has been studying Chinese mentality and aims for decades. What are the implications if he proves correct?